

Conversations on Economic Inclusion with Dan O’Flaherty

Dionissi Aliprantis

This is Conversations on Economic Inclusion. I'm Dionissi Aliprantis, the director of the Program on Economic Inclusion here at the Federal Reserve Bank of Cleveland. In our program, we aim to bring together researchers and practitioners to learn about what it takes for more people to participate more fully in the economy.

When we think about economic inclusion, we think about what it takes for more people to participate more fully in the economy. We can look across a number of groups and find gaps in people’s participation, but some of the starkest gaps fall along racial lines. Black households in particular have lower average wealth, income and employment rates than white households. They also live in neighborhoods with remarkably different socioeconomic characteristics.

To learn more about what’s behind these gaps, I spoke with Professor Dan O’Flaherty. He’s an economist at Columbia University and he published a book on this topic in 2015 called *The Economics of Race in the United States*. Professor O’Flaherty discussed what the economics research tells us about racial inequality in the labor market.

Before we get started, I should mention that the views expressed here are those of the participants, and not necessarily those of the Federal Reserve Bank of Cleveland or the Federal Reserve System.

And now, here’s my conversation with Professor O’Flaherty.

TRANSITION

Dionissi Aliprantis

Thinking about the economics literature on employment and earnings and how that interacts with race, I'm wondering if you could give a summary of some of the major findings in the literature on discrimination in the labor market. I guess the place I would start the conversation is - detecting discrimination is pretty hard to do. One of the ways that we've done that in economics is to look at audit studies. I'm wondering if you could describe audit studies generally, some of the big results recently. I'm thinking of Bertrand and Mullainathan (2004), but also since your book was published, Kline, Rose, and Walters (2021).

Dan O'Flaherty

What audit studies do is that audit studies can tell us about process. They cannot tell us about outcomes. What audit studies started out being was sending pairs of people who were trained to act in the same way to employers, one was Black, one was white. They apply. They see what happens. The results there have generally been almost always, the employers treat both the same in that they don't get the job or get a callback.

To the extent that we see them getting callbacks, generally, the white auditors get called back more. This was criticized by Jim Heckman with one very good objection, which I'll come back to, and one serious objection, which was met, which was that the auditors know what's going on. They're going to play. You can't trust them.

Bertrand and Mullainathan had this wonderful idea of sending out resumes with Black sounding names and white sounding names and looking at what the response was about calling back. Once again, they found that very few people get called back. To the extent that there are callbacks, white-sounding names do better than Black-sounding names.

Now, this moved in meeting one of Heckman's objections, in that there are no auditors, so they can't play.

It moved further from Heckman's other objection, which I would say is more definitional in that you can't imagine anyone being worse off about this because there's no one to be worse off. If I had a pizza store, I would never hire a Kardashian, and I mean, it's probably wrong of me, but there are no consequences of that in the world. In legal terms, I think what the auditors do are looking for disparate treatment. They're looking for bad motive.

Dionissi Aliprantis

And you're more interested in disparate impact, or this Heckman critique is.

Dan O'Flaherty

The disparate treatment is interesting. If you're interested in disparate impact, you want to know a mechanism for disparate impact and disparate treatment might be the mechanism, so it's interesting how it works there. I think also, the other thing about the audit studies is they find that there are asymmetries in both directions. They don't find that no employers ever call back Blacks and not whites. There are some who call back Blacks and not whites and some in other direction. What they find is the preponderance goes in the direction of helping whites.

Dionissi Aliprantis

But that matters a lot for the Heckman critique, right?

Dan O'Flaherty

That's what the Kardashians have managed to do pretty well for themselves, without ever getting a job as a research assistant for me. They didn't need me. That's why I think it's important. I think a lot of the discussion of discrimination has gotten hijacked on the minutiae, where the preponderance of it is what matters.

So, I believe very firmly that you treat your kids better than you treat me. That if one of your kids and I were having birthday parties the same day, and I invited you and they invited you, you would show up at their birthday party.

Dionissi Aliprantis

Yeah. I'm sorry to confirm, that's probably what would happen.

Dan O'Flaherty

Yep. And I am no more deserving than your kids or your kids are no more deserving than I am. And one, I don't take it personally, but you show an unreasonable preference for your kids, and I hope you do. What I would say is that we have this kind of discrimination going on all the time. And there are barbershops that will not cut my hair. I've managed to go do pretty well in life without. I have never gotten an offer of employment from North Korea, although I'm probably a better economist than anybody that they have.

Dionissi Aliprantis

But don't you think this whole question though gets back to the issue of power, but also just I think of how resources are already distributed throughout the economy. I mean, you could think about it in terms of a job ladder, but you could think about it in lots of ways where it could be the case that not being able to get that job means you don't get that opportunity. And there's more of a consequence than for example, me not showing up at your birthday party.

If it were the case that, for example, let's say the best birthday present that you were going to get was coming from me and then I choose to go to my daughter's, that could be more of an issue.

Dan O'Flaherty

I'm not saying that discrimination isn't an issue. I'm saying that there is lots of discrimination going on that really doesn't matter. There is some that does matter.

Dionissi Aliprantis

And it's hard for us to know.

Dan O'Flaherty

Well, what we know is that when it's pervasive, if nobody comes to my birthday party, then I'm in trouble. I think, the evil or the harm comes from pervasive discrimination.

Where we come in the other kind of studies, the disparate impact studies, the wage regressions, they show that, okay, the preponderance matters. That in fact, all sorts of bad things happen to white people. All sorts of bad things happen to Black people, but on net, it is worse off for Black people.

Dionissi Aliprantis

Well, and I guess that would maybe point to the other topic I wanted to talk about with you.

thinking about this issue of the role of education in the labor market and racial disparities, I'm thinking both in terms of attainment and achievement, I'm wondering if even before we talk about racial disparities, some of the work that for example, and maybe it would just be estimated entirely on a sample of say, white males, like I'm thinking about, for example, Keane and Wolpin (1997), but where they're finding things like a large share of lifetime labor market outcomes can be explained by more or less what's happened to you by age 16 or 18. How do you think about that and the connection with education?

Dan O'Flaherty

You better get educated. Yeah, a large part. But one of the things that has been coming out since the book has been... or at least coming to my attention since the book, the importance of the social and behavioral parts of that, what used to be called non-cognitive, which was a...

Dionissi Aliprantis

But it actually is cognitive, so we've moved away from that. It actually is cognitive.

Dan O'Flaherty

A large part of what goes on probably is determined in the social and behavioral, as well as what used to be called cognitive parts, as well as-

Dionissi Aliprantis

Test scores or something like that, your math and your reading.

Dan O'Flaherty

Yeah. And the sleeper effects there, where we have all these interventions that happen earlier in life, they do nothing to test scores until... but then you find out at age 20, they make all the difference in outcomes in your life that really matter.

Dionissi Aliprantis

I guess this question about test scores, when they're informative? Whether they're informative? What they actually are measuring? Could you talk a little bit about some of the research on using the National Longitudinal Surveys of Youth 1979 wave, and the AFQT variable in there. Can you speak a little bit about that?

Dan O'Flaherty

Sure. So, there's this important paper by Neal and Johnson in 1996, which the framework is interesting. They look at a two-stage process. They imagine life as a two-stage process, in which you're a kid and that after ceasing to be a kid, you're a worker. And there can be discrimination in both stages.

Their question is, is there second stage discrimination? And what they propose is that if you look at test scores around age 18, then, Armed Forces Qualifying Test scores (AFQT), these particular cognitive tests, this test score summarizes everything relevant that you have learned up until age 18, and it is what you bring to the labor market. Now, the interesting thing to me, since I've been thinking about this recently in a police homicide context, is that the overlap between Black AFQT scores and white AFQT scores is very small.

Dionissi Aliprantis

That's right.

Dan O'Flaherty

And they give themselves degrees of freedom, and they find that for everyone except Black men, for Hispanics, and Black women, the AFQT difference explains the difference in earnings in the late 20s. And instead of a 20% difference for Black men, it becomes a seven-point difference. This has inspired a wonderful amount of research and a wonderful amount of thought, and I don't know if they believe it anymore.

Dionissi Aliprantis

in my mind, when I think of maybe two of the most important papers in response or connected to that paper, I would think of Rodgers and Spriggs (1996), and then I would think about more recently, Eric Nielsen's work trying to anchor items in the actual test. So, I'm curious, when you say you don't know if you believe it anymore-

Dan O'Flaherty

I don't know if they believe it anymore.

Dionissi Aliprantis

You don't know if they believe it. So, I guess, how do you think about it? How do you think about I guess the contribution of these...? Let's call them cognitive skills to labor market outcomes. Because I think one of the ways I would interpret it and I guess, okay, I'll spill the beans. I'll explain my own views on it. And then I'll maybe hear yours and we can go back and forth.

My own views are that even if it's not as large as they find, and even if Eric Nielsen's work isn't perfect, I think what it's saying to me is that education does matter, and as you said, it's not the panacea. It's not going to solve all the other forms of discrimination in the labor market. It's not going to necessarily solve residential issues.

But I guess the way I see it is, okay, what this is saying is that these kind of cognitive skills or whatever it is that's measured in these tests, it does matter for the labor market. And the thing that I find encouraging is that that is something we can work on. That's something that I think we can change. That to me feels like solving the problem.

Dan O'Flaherty

I definitely agree with that. I mean, I think what I've realized recently is that there is a very active literature in policing which is the exact same problem. So, you have one stage in which a police officer arrests somebody and a second stage in which a district attorney makes a charging decision. Or there's a judge, many, many stages, actually.

Dan O'Flaherty

The question that was a very active debate two summers ago was what can you say about the second stage? Given that you have in this case, you have a really hard time observing the first stage, because you cannot observe the people whom the officer did not arrest. How do you think about the second stage? Nobody in this said that it is not important whom they arrest.

Dionissi Aliprantis

Yeah, clearly that is.

Dan O'Flaherty

And I think the people that I find most telling on this have argued you look at the information set of the people at the second stage, and you have a well-formulated question about whether they acted in a discriminatory manner or not. I mean, this is the opposite of we have good data on kids, we don't have good data on employers, where here you have good data on prosecutors

Dan O'Flaherty

Here, let's go to the employment case. I think employers, under law, employers do have an obligation, certain fiduciary obligations to applicants. In some cases, if I'm a little guy, I'm hiring people for my pizza store-

Dionissi Aliprantis

No big deal.

Dan O'Flaherty

Once I've turned the Kardashians away, I don't have to go further. And I can see somebody's resume. I can see they went to a school, which I never heard of. I'm not going to hire them, because I really want

smart pizza delivery people. But if I'm a large employer, then I ought to question how good the information is that I'm getting from the first stage.

Dionissi Aliprantis

So, you're drawing an analogy with the district attorney receiving people that have been arrested and saying, "You need to investigate that process a little bit." And now you're saying, "Okay, let's think about large employers, that they should be investigating a little bit the process by which someone's presenting to them with whatever credentials, or..."

Dan O'Flaherty

And if you look at how affirmative action works in large employers, the stories that we have and actually some data on this is, "What does it do?" Coming under affirmative action requirements forces employers to go back and look in the first stage in the sense that they find sources of referral. They find schools, they learn about them. They improve their ability to judge the first stage.

Dionissi Aliprantis

Potential.

Dan O'Flaherty

And then we've got Conrad Miller's result, that they keep using it once they've made the investment. We saw in Conrad's paper that it seems to be profit maximizing, once you've set it up.

Dionissi Aliprantis

I do want to actually turn to that paper by Conrad Miller and Ian Schmutte. I think you're talking about the co-authored recent paper where, so they look at data from Brazil. That includes the race of the entrepreneur who started a business.

Dan O'Flaherty

No. No. No. No. This is an earlier bit.

Dionissi Aliprantis

You're talking about a different one? Okay.

Dan O'Flaherty

Yeah.

Dionissi Aliprantis

Well, I want to talk about this one from Brazil.

Dan O'Flaherty

Let's go. Let's go. Conrad Miller's good. We can always talk about Conrad.

Dionissi Aliprantis

Okay.

Dan O’Flaherty

Yeah.

Dionissi Aliprantis

So, this paper, with this co-authored paper, they find that businesses that are started by white founders end up hiring Black employees at the same rate as businesses started by Black founders. But that it takes time. And so, they're able to interpret this in terms of a story about job referral networks. And essentially, they're saying you can see that a job referral network might be segregated because social networks are segregated.

And social networks maybe are segregated because of residential segregation and how important, I guess, job referral networks are in the hiring process. They're tremendously important. And the evidence that we have is that it's stronger for lower income people. So, I'm curious if you could, I don't know, interpret that, or speak about that and how that connects with just the issue of residential segregation.

Dan O’Flaherty

Okay. Yeah. I think job referral networks are important. The first Conrad Miller paper also was about job referral networks, in the sense that one of the reasons for the continued hiring of Black employees was that the job referral networks were set up. And that's again, what I would think about as due diligence.

Like the district attorney checking on what goes on in the first stage, if I'm not getting any referrals from this neighborhood or this group of people, maybe I ought to find out why and take steps to get referrals.

Dionissi Aliprantis

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